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THE SENATE OF MARYLAND
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TESTIMONY OF SENATOR SHELLY HETTLEMAN
SB 766 FAIR SHARE FOR MARYLAND ACT OF 2024

The complexity and breadth of the Maryland tax system reflects the diversity of the State, its industries, and its residents. However, the current system has loopholes which disproportionately benefit few at the expense of the majority. In fact, a significant portion of the state's largest corporations pay little or no income taxes in a typical year.[i] Senate Bill 766 aims to address these shortcomings and to ensure that every resident and business within Maryland pays their fair share, while also receiving equitable benefits.

SB 766 includes several components that will reform the Maryland tax system:

1. Lower the Estate tax unified credit.
2. Close the pass-through business loophole.
3. Implement combined reporting requirements.
4. Incorporate throw-back rules.
5. Reform the capital gains tax framework.
6. Modify personal income tax rates.
7. Modify Maryland's Child Tax Credit and Earned Income Tax Credit

Estate Tax

An estate tax is applied to the value of the estate of a deceased person. At both the state and federal levels, exemption limits have been placed allowing for estates of less than a certain amount to not be taxed. In 2014, Maryland increased this limit gradually to $5 million.[ii] Under this modification, exceptionally wealthy individuals have been able to have a larger portion of their estate be exempt. On average, American households inherit $46,200, though less than a third of households receive any money.[iii]

SB 766 would lower the state's estate tax exemption limit from $5 million to $2 million, ensuring that the very wealthy pay their fair share. Through 2014, Maryland exempted the first $1 million of an estate from taxes which resulted in only the largest 3% of estates being subject to the tax.[ii] Increasing the limit to $2 million acknowledges the economic changes within Maryland over the past decade as well as the reality that the passage of wealth looks different for every family. Nevertheless, taxing inherited wealth, especially to the tune of millions of dollars, is an important component of an equitable tax system.

Pass-through Businesses

Corporations are generally double tax entities, meaning that their income is taxed at the corporate tax rate and the owners or shareholders of the corporation are also taxed for the same income. Conversely, pass-through entities—which include sole proprietorships, LLCs, partnerships, LLPs, and S Corporations—are not double taxed since the profits and losses "pass-through" directly to the owners and shareholders who pay taxes on that income at their personal tax rate.[iv]

SB 766 addresses a growing issue in which corporations use existing loopholes meant to benefit small businesses to avoid having to pay corporate taxes on their income. This "LLC loophole" is targeted by the bill via exempting $1 million of a pass-through entity while taxing income above $1 million. This approach ensures that only the largest and wealthiest businesses rather than the backbone of our economy – small businesses - pay their fair share.

<u>Combined Reporting and The Throwback Rule</u>

Combined reporting is a corporate income tax reporting framework where the taxes of affiliated taxpayers—including parent and subsidiaries companies—are reported as if they conducted business as a single legal entity for state income tax purposes.[v] Another reporting and taxation reform is the implementation of the throwback rule. Under this rule, if a corporation with facilities in Maryland has income which is not taxed by any other state that income is "thrown back" into Maryland and taxed here.

Combined reporting assists with capture "nowhere" income—corporate income which is not generally taxable by states due to lack a sufficient "nexus," such as a physical location, between the state and corporation. This is a prominent issue with companies that are set up in a certain state but do significant business elsewhere. A majority of states and DC have adopted combined reporting to some extent.[vi] Like combined reporting, throwback is meant to address gaps in taxation for multi-state corporations and ensure they truly pay their fair share within the state they are operating. Currently, nineteen states and DC have throwback rules.[vii]

SB766 would implement both structures into Maryland's tax system, ensuring that multi-state companies that call Maryland home or do business here pay their fair share of taxes as they continue to receive the economic benefits of operating within the state.

<u>Capital Gains</u>

Capital Gains tax is paid by an investor on the profit that they make when an investment is sold unless the sale is made upon death of the owner or donated to charity.[viii] About 80% of capital gains go to the wealthiest 5% of taxpayers.[ix] Additionally, for 99% of American households, less than 4% of income comes from capital gains.[x] Comparably, 45% of income comes from capital gains for the top 1% of American households. In Maryland, capital gains are taxed as part of an individual's income taxes, which means that investment income is taxed at the same rate as earned income. This means that prior to selling their capital gains, a significant portion of a wealthy household's income is not being taxed as the same households without capital gains, leading to a lower tax burden for the wealthiest Marylanders.

SB 766 simply imposes a 1% surtax on capital gains, which would help to provide revenue for the state while minimally impacting the vast majority of Marylanders due to exclusions for the sale of certain investments more widely accessible and utilized.

<u>Personal Income Tax and Tax Credits</u>

Currently, Maryland's income tax rate brackets group together households with incomes over $250,000 or over $300,000 depending on filing status. The estimated median household income in Maryland for 2022 was $108,200, making the state one of the wealthiest in the nation.[xi]

However, it should also be noted that Maryland ranks second in the nation in per capita millionaires, which make up nearly 10% of the state's households.[xii]

SB 766 modifies the income tax rate to better reflect the stratifications of Maryland residents and more equitably tax residents. Under the bill, a new 6%, 6.5%, and 7% tax rate will be created with the highest bracket being changed to "in excess of $1,000,000" and "in excess of $1,200,000" based on filing status. While the wealthiest 1% of Marylanders will see an increase meant to have them pay their fair share, this tax rate increase will, on average, be less than 1% of their income.[i]

In addition to changes to tax rate, SB766 modifies and expands both the child tax credit and earned income tax credit to allow more households to save on their taxes, especially those who are low-and-moderate income. Under the change, households with incomes less than $165,000 are estimated to see a tax cut of $149. And those with incomes of up to $250,000 should see no change at all.

Overall benefits

Multiple states have proposed "wealth taxes" with the goal of ensuring that residents of all economic classes pay their fair share.[xiii] This bill combines components from multiple previously introduced bills, as well as introduces new tax reforms with the goal of ensuring equity and prosperity for all residents of Maryland. This bill will increase revenue for the state which will help to address the myriad essential services requiring funding. According to Fair Share Maryland, these actions will result in an estimated $1.58 billion in net revenue for the state.[i] Additionally, SB 766 will result in more than $400 million in EITC and Child Tax Reform.[i]

Under the tax reforms proposed by the Fair Share for Maryland Act, the state, its economy, and its residents will benefit.

I urge a favorable report on SB 766, and I thank you for your consideration.

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[i] *The Fair Share for Maryland Plan to Benefit Working Families*, Fair Share Maryland, https://fairsharemaryland.org/wp-content/uploads/Fair-Share-for-MD_Overview_012324.pdf (last visited Feb 16, 2024).

[ii] Maryland Department of Legislative Services, "Fiscal and Policy Note for House Bill 739, Maryland General Assembly 2014 Legislative Session, http://mgaleg.maryland.gov/2014RS/fnotes/bil_0009/hb0739.pdf

[iii] Eric Reed, *Average American inheritance, by wealth level*, Yahoo! Finance (2024), https://finance.yahoo.com/news/average-american-inheritance-wealth-level-130120356.html?guccounter=1&guce_referrer=aHR0cHM6Ly93d3cuYmluZy5jb20v&guce_referrer_sig=AQAAAAdQu0G4Uz2er_1zKAg2v_T8ztKCbD2GK8xjyM8H7G_502KE21HYnNJMl8qpY6ucdv-ekGb0_mHO4PYCGG3HL6iKcJFOSez-K-Lylc8LpfHtoJmglRAWwc3irba0ecOwXg5P25XLUb4Eh_S31FUuiavnPvn1GBXOgsBedjV1pLZQ (last visited Feb 16, 2024).

[iv] *Pass-through tax deduction law for business owners*, Justia (2023), https://www.justia.com/tax/corporate-tax/business-tax-deductions/pass-through-tax-deduction/ (last visited Feb 16, 2024).

[v] Andrew Griffin, *Understanding combined reporting in Maryland: 5 top questions answered*, Maryland Chamber of Commerce (2023), https://www.mdchamber.org/2021/08/27/understanding-combined-reporting-in-maryland-5-top-questions-answered/ (last visited Feb 16, 2024).

[vi] 28 states plus D.C. require combined reporting for the State Corporate Income Tax, Center on Budget and Policy Priorities (2020), https://www.cbpp.org/28-states-plus-dc-require-combined-reporting-for-the-state-corporate-income-tax (last visited Feb 16, 2024).
[vii] Janelle Fritts, Does your state have a throwback or throwout rule? Tax Foundation (2023), https://taxfoundation.org/data/all/state/state-throwback-rule-state-throwout-rule-2023/ (last visited Feb 16, 2024).
[viii] Jason Fernando, *Capital gains tax: What it is, how it works, and current rates* Investopedia, https://www.investopedia.com/terms/c/capital_gains_tax.asp (last visited Feb 16, 2024).
[ix] Elizabeth McNichol, *State taxes on Capital Gains*, Center on Budget and Policy Priorities (2021), https://www.cbpp.org/research/state-budget-and-tax/state-taxes-on-capital-gains (last visited Feb 16, 2024).
[x] Increasing taxes on capital gains requires trade-offs, Tax Foundation (2019), https://taxfoundation.org/increasing-capital-gains-taxes-requires-trade-offs/ (last visited Feb 16, 2024).
[xi] *Maryland at a glance*, Maryland Economy - Income, https://msa.maryland.gov/msa/mdmanual/01glance/economy/html/income.html (last visited Feb 16, 2024).
[xii] Ali Hassan, *5 states with the most millionaires per capita in the US*, Insider Monkey (2023), https://www.insidermonkey.com/blog/5-states-with-the-most-millionaires-per-capita-in-the-us-1243726/4/ (last visited Feb 16, 2024).
[xiii] David W. Chen, *Vermont becomes latest state to propose wealth taxes* The New York Times (2024), https://www.nytimes.com/2024/01/23/us/wealth-tax-vermont-legislature.html (last visited Feb 16, 2024).